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THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER DISTRICT AND ITS SUN CITY WATER DISTRICT.

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM/ AGUA FRIA WASTEWATER DISTRICT, ITS SUN CITY WASTEWATER DISTRICT AND ITS SUN CITY WEST WASTEWATER DISTRICT

DOCKET NO. SW-01303A-09-0343
INTERVENER ANTHEM COMMUNITY COUNCIL'S POST-HEARING REPLY BRIEF

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

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SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

The Anthem Community Council, Inc. ("Anthem") hereby submits its Post-Hearing Reply Brief. On any issue not specifically addressed herein, Anthem maintains the positions set forth in its April 16, 2010 Pre-hearing Memorandum on Disputed Refund Payment Issue and in its July 16, 2010 Initial Post-Hearing Brief on all issues therein addressed.

I. INTRODUCTION

Anthem's Post-Hearing Reply Brief addresses the following issues. In Sections I.A. and B. hereof, Anthem argues that because the Infrastructure Agreement (as defined below) has not been duly approved by the Arizona Corporation Commission ("Commission") in accordance with Arizona law and because Arizona-American Water Company ("AAWC") has not proved the reasonableness of the Disputed Refund Payments (as defined below), all or a portion of the Disputed Refund Payments should be permanently excluded from rate base and denied any related ratemaking recognition. In Section II.C., Anthem argues that if, however, the Commission allows ratemaking recognition of all or a significant portion of the Disputed Refund Payments, then the Commission should mitigate the attendant rate shock for Anthem water and wastewater ratepayers by implementing a phase-in plan. In Section II.D., Anthem demonstrates that, due to mathematical errors affecting the Staff's prior calculations, the portion of the Northwest Treatment Plant cost allocated to the Anthem/Agua Fria Wastewater District for stand-alone ratemaking purposes should be reduced from the Staff's proposed 28% to 16.5%. In Section II.E., Anthem discusses why AAWC's actual borrowing costs warrant a fair and reasonable rate of return of 6.37%. In Section II.F, Anthem articulates its continued support for company-wide rate consolidation as a useful long-term strategy for increasing efficiencies in the provision of water and wastewater services. Finally, in Section II.G., Anthem proposes an alternative stand-alone rate design modified by the deconsolidation of the Anthem/Agua Fria Wastewater District, in the event that the Commission declines to order company-wide consolidation in this proceeding.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

II. ANALYSIS

A. AAWC's Post-2005 Refunds to Pulte Should Be Permanently Excluded from the Rate Base and Denied Any Related Ratemaking Recognition.

In its April 16, 2010 Pre-hearing Memorandum and in its July 16, 2010 Initial Post-Hearing Brief, Anthem contended that because the Agreement for the Villages At Desert Hills Water/Wastewater Infrastructure, dated September 28, 1997, between Citizens Water Resources ("Citizens"), as predecessor in interest to AAWC, and Del Webb Corporation, as predecessor in interest to Pulte Corporation ("Pulte"), as amended (the "Infrastructure Agreement"),[1] was not approved by the Commission as required by law, the Commission should (i) permanently exclude from AAWC's rate base, and (ii) deny any associated ratemaking recognition of the 2007 $3.1 (the "2007 Refund") and March 31, 2008 $20.2 million refund payments (the "2008 Refund") (collectively, the "Disputed Refund Payments") made by AAWC to Pulte pursuant to the Infrastructure Agreement.[2] More specifically, as Anthem therein demonstrated, because the Commission never issued an order authorizing the Infrastructure Agreement as required by Sections 40-301 *et seq.* of the Arizona Revised Statutes ("A.R.S."), the Infrastructure Agreement and AAWC's resulting obligation to pay the Disputed Refund Payments are void. In response, in its July 16, 2010 Post-Hearing Brief, AAWC argued that (i) the Infrastructure Agreement is not "evidence of indebtedness" under A.R.S. § 40-301 and (ii) because the Commission, upon the Commission Staff's ("Staff") recommendation, declined to approve the Infrastructure Agreement on several previous occasions, the Commission is estopped from now holding that the Infrastructure Agreement required prior Commission approval. The Commission should reject AAWC's legal arguments and conclusions for the reasons set forth below.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

[1] Amendments to the Infrastructure Agreement include the Letter Agreement, dated November 24, 1998, the First Amendment to Agreement for Anthem Water/Wastewater Infrastructure, dated May 1, 2000, the Second Amendment to Agreement for Anthem Water/Wastewater Infrastructure, dated September 1, 2000, the Third Amendment to Agreement for Anthem Water/Wastewater Infrastructure, dated December 12, 2002, and the Fourth Amendment to Agreement for Anthem Water/Wastewater Infrastructure dated October 8, 2007 (the "Fourth Amendment").

[2] The second payment under the Fourth Amendment, and last payment to Pulte, paid by AAWC on March 31, 2010, in the amount of $6,742,041 is not included in this rate case. *See* Cross-examination of Thomas M. Broderick, Phase I Tr. at 241:25-242:15.

1. The Commission has explicitly rejected the notion that "evidence of indebtedness" refers only to traditional indebtedness for borrowed money.

In supporting its claim that the Infrastructure Agreement is not evidence of indebtedness, AAWC cites to Decision No. 69947[3] as standing for the proposition that the Commission relies on generally accepted accounting principals ("GAAP") to determine whether evidence of indebtedness exists and whether prior Commission approval is required under A.R.S. §§ 40-301 *et seq.*[4] In so doing, AAWC erroneously extends the scope of the Commission's application of GAAP in order to reach the conclusion AAWC desires in this proceeding. In the proceeding which resulted in Decision No. 69947, Arizona Public Service Company ("APS") requested blanket approval for its financing activities and related increases to the debt limits imposed on APS by law and by previous Commission orders.[5] In order to avoid the need for further Commission approval, APS asked the Commission to issue a declaratory order (i) confirming that only traditional indebtedness for borrowed money constituted evidence of indebtedness pursuant to A.R.S. § 40-301 and (ii) exempting from APS's debt limits certain agreements that did not constitute traditional indebtedness but which could be treated as debt by GAAP, like power purchase agreements and long-term fuel supply contracts.[6] The Commission declined to confine "evidence of indebtedness" to traditional indebtedness for borrowed money and stated that "the purpose of long-term debt limits would be frustrated if APS could structure the form of its debt to avoid those limits."[7]

The Commission's unwillingness to limit the definition of "evidence of indebtedness" to traditional forms of indebtedness recognizes that financing mechanisms have evolved since the original adoption of A.R.S. § 40-301 and Arizona's admission into the Union in 1912. For

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[3] Docket No. E-01345A-06-0779.

[4] Post-Hearing Brief of Arizona-American Water Company at 22 n. 115. In asserting this position, AAWC acknowledges that agreements treated as capital leases under GAAP, like the City of Glendale Sewage Transportation Agreement (the "Glendale Agreement"), are subject to the approval requirements and must be accounted for in the debt limits set forth in A.R.S. §§ 40-301 *et seq.* *See* Post-Hearing Brief of Arizona-American Water Company at 10 *and see* Financial Accounting Standards No 13. Anthem does not know whether AAWC received prior authorization from the Commission for the execution and delivery of the Glendale Agreement.

[5] Commission Decision No. 69947, Docket No. E-01345A-06-0779 at 3, 4.

[6] *Id.* at 10-11. The Commission denied APS's request to exempt the vehicle lease and trailer rental agreement from its debt limits and opined that debt classified as debt by GAAP would be subject to "appropriate controls established by the long term debt limitations established by the Commission." *Id.* at 11. The Commission did, however, approve APS's proposed provisions regarding the future classification of contractual arrangements "if APS were to exceed its authorized debt limits as a result of future changes to GAAP or future changes in the interpretation of GAAP." *Id.* at 11, 17-18.

[7] *Id.* at 12.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

example, in order to avoid statutory debt limitations and public voting requirements, instead of issuing bonds, governmental entities frequently enter into lease transactions for capital improvements and then sell certificates evidencing undivided proportionate interests in the lease to investors.[8] The leases can be structured either as capital leases, which would be treated as debt by GAAP, or as operating leases which are not treated as debt by GAAP.[9] Similarly, interest rate swap agreements and other derivative agreements, while not technically considered debt under GAAP or Arizona law, normally mirror debt obligations and can have significant financial consequences on the parties thereto.[10] By recognizing that the term "evidence of indebtedness" includes non-traditional financing mechanisms,[11] the Commission retains full regulatory control over public service corporations and avoids the unintended consequence of providing a given utility with "a mechanism for circumventing these controls."[12]

2. The Infrastructure Agreement is a secured financing arrangement.

AAWC suggests that the Infrastructure Agreement was executed for the limited purpose of ensuring that Pulte bore the risk associated with the community's development.[13] If that were true, then why did AAWC back its indebtedness by issuing letters of credit benefiting Pulte? Generally, notes, letters of credit, and guarantees are indicative of financing transactions. The Infrastructure Agreement is essentially a financing agreement whereby Pulte financed the construction of Anthem's water and wastewater facilities through an interest-free loan. In return, AAWC secured

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[8] Examples of official statements related to the issuance of certificates of participation can be found at www.emma.msrb.org. The Securities and Exchange Commission (the "SEC") requires all official statements for publicly -traded municipal securities to be filed with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access facility. Rule 15c2-12 adopted by the SEC under the Securities and Exchange Act of 1934, as amended.

[9] *See* Financial Accounting Standards No. 13. In Staff's July 16, 2010 Initial Post-Hearing Brief, Staff surmises that the legislature did not intend for items like contracts for office furniture or computer services to require prior Commission approval pursuant to A.R.S. §§ 40-301 *et seq.* Staff's Initial Post-Hearing Brief at 15. However, in the event that the contracts were structured as capital leases or constituted financing arrangements secured by the issuance of notes, letters of credit or guarantees, prior Commission approval may be required. *See* ns. 4, 6 and 11.

[10] *See* Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" and A.R.S. Title 35, Chapter 8.

[11] A common definition of "indebtedness" in financial agreements filed with the SEC is as follows: "'Indebtedness' with respect to any Person means, at any time, without duplication, (a) its liabilities for borrowed money and its redemption obligations in respect of mandatorily redeemable preferred stock; (b) its liabilities for the deferred purchase price of property acquired by such Person (excluding accounts payable arising in the ordinary course of business but including all liabilities created or arising under any conditional sale or other title retention agreement with respect to any such property); (c) all liabilities appearing on its balance sheet in accordance with GAAP in respect of capital leases; (d) all liabilities for borrowed money secured by any lien with respect to any property owned by such person (whether or not it has assumed or otherwise become liable for such liabilities); (e) all its liabilities in respect of letters of credit or instruments serving a similar function issued or accepted for its account by banks and other financial institutions (whether or not representing obligations for borrowed money); (f) swaps of such person; and (g) any guaranty of such person with respect to liabilities of a type described in any of clauses (a) through (f) hereof." *See e.g.*, Primerica, Inc., $300,000,000 5.5% Notes due March 31, 2015, Note Agreement, dated April 1, 2010; Stock Purchase Agreement, between Ultrapetrol (Bahamas) Limited, as buyer, and Crosstrade Maritime Inc. and Crosstrees Maritime Inc., as sellers, dated as of March 20, 2006; First Amended and Restated Credit Agreement, dated as of December 16, 2009, among Cubic Corporation, the lenders party hereto, and JPMorgan Chase Bank, N.A., as administrative agent.

[12] *See* Staff Report, Docket No. E-01345A-06-0779 at 5.

[13] Post-Hearing Brief of Arizona-American Water Company at 24.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

its indebtedness to Pulte through the issuance of two letters of credit. In stark contrast to the application of the statutory construction doctrine of *ejusdem generis* advanced by AAWC in its July 16, 2010 Initial Post-Hearing Brief, A.R.S. §§ 40-301 *et seq.* clearly applies to the Infrastructure Agreement because, like stocks, bonds, notes and other financing mechanisms, the Infrastructure Agreement was used to finance AAWC's capital improvements and thus is a "financial instrument[s] used to build up the permanent capital structure of the utility."[14] Significantly, AAWC's audited financial statements note that advances in aid of construction ("AIAC") are listed, together with proceeds from debt issuances, net borrowings from notes, and capital contributions, under the heading "Cash flows from financing activities."[15] Also of significance, the Staff Report and related schedule issued in relation to AAWC's August 26, 2009 financing application indicate that, in addition to the regular capital structure, the Commission also considered "the Company's actual capital structure at December 31, 2008, inclusive of advances in-aid-of-construction ('AIAC') and net contributions-in-aid-of-construction ('CIAC')" in the calculation of short-term and long-term debt.[16] Given these considerations, AAWC's comparison of the Infrastructure Agreement to an unsecured personal services contract with an office cleaning company is disingenuous at best.

3. The Infrastructure Agreement is void.

The Infrastructure Agreement is void because the Commission did not issue an order authorizing the Infrastructure Agreement prior to its execution and delivery. Neither retroactive approval of the Infrastructure Agreement nor a conclusion that prior non-approval is tantamount to authorization of the Infrastructure Agreement required by A.R.S. §§ 40-301 *et seq.* meets the requirements of Arizona law and, thus, such suggestions should be rejected by the Commission. In *George v. Arizona Corp. Commission*,[17] the Court prevented the Commission from retroactively issuing a corrected certificate of public convenience and necessity in 1951 to a transportation company when the Commission's rules and regulations mandated that a hearing take place prior to

[14] *Id.* at 23-24.
[15] Arizona-American Water Company (a wholly-owned subsidiary of American Water Works Company, Inc.) Financial Statements as of and for the years ended December 31, 2008 and 2007 at 5.
[16] Staff Report, Docket No. WS-01303A-09-0407 at 13.
[17] 83 Ariz. 387, 322 P.2d 369 (1958).

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

October 1, 1937. In that case, the Court held that the Commission must follow applicable law and observed that "retroactive regulations are just as obnoxious as retroactive laws."[18] *George* instructs that retroactive approval of the Infrastructure Agreement by the Commission is not an option. Similarly, the Commission's previous non-approval of the Infrastructure Agreement cannot be treated as prior authorization of the Infrastructure Agreement under Arizona law. According the Commission's previous decisions not to act upon the Infrastructure Agreement the same legal effect as authorization under A.R.S. §§ 40-301 *et seq.* ignores the Commission's underlying intent in previously declining approval of the Infrastructure Agreement. Succinctly stated, the Commission did not wish to bless the Infrastructure Agreement because of "concerns raised by Staff with respect to certain conditions contained in the [Infrastructure] Agreement."

Further, in *George*, the Court reiterated that "where the public interest is involved neither estoppel nor laches can be permitted to override that interest."[19] In that regard, in Decision No. 64897, the Commission explicitly declined to approve the Infrastructure Agreement, in part, in order to protect "its [future] rights to set rates and conditions it deems necessary to protect public interest."[20] Accordingly, AAWC does not have a claim for laches or equitable estoppel in this instance. The Commission cannot be estopped from complying with applicable law and cannot be precluded from now definitively resolving the legal status of the Infrastructure Agreement and the Disputed Refund Payments.[21] Simply put, there should be no question of choice for the Commission as between what the law requires and what AAWC, or any other party, believes is fair. Clearly, the law must prevail.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

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[18] *Id.* at 391, 322 P.2d at 371 (citing *Taylor v. McSwain*, 54 Ariz. 295, 95 P.2d 415, 422 (1939)).

[19] *Id.* at 391 citing *Pacific Greyhound Lines v. Sun Valley Bus Lines*, 70 Ariz. 65, 68, 216 P.2d 404 (1939). *See also, State ex rel. Sullivan v. Moore*, 49 Ariz. 51, 62, 64 P.2d 809, 814 (1937) and *City of Bisbee v. Cochise County*, 52 Ariz. 1, 78 P.2d 982 (1938) for the principal that "neither laches nor its generic parent, estoppel, can be asserted to gain rights against the public or to defeat the public interest."

[20] Decision No. 64897, Docket No. WS-03455A-00-1022 at 6 citing Staff Report at 3.

[21] Similarly, AAWC's argument that the Commission has never required approval of infrastructure agreements is not instructive nor persuasive. In *U.S. Parking Systems v. Phoenix*, 160 Ariz. 210, 212, 772 P.2d 33, 35 (App. 1989) the court stated that, where it clearly appears that an administrator's prior statutory interpretation is wrong, courts need not defer to the administrator. *See also Board of Accounting v. Keebler*, 115 Ariz. 239, 241, 564 P.2d 928, 930 (App. 1977) (the issue of statutory interpretation is one of law and courts are free to draw their own legal conclusions and are not limited to the review standards of arbitrary, capricious or abuse of discretion.)

B. Alternatively, Any Portion of the Disputed Refund Payments That Has Not Been Shown by AAWC To Be Reasonable and Proper Should Be Permanently Excluded from the Rate Base and Denied Any Related Ratemaking Recognition.

Because of both (i) the impending significant rate impact on Anthem residents and (ii) significant doubt regarding the legality of AAWC's "obligation" to make the Disputed Refund Payments, AAWC should not be allowed ratemaking recognition of the payments related to the Infrastructure Agreement without first proving that the Disputed Refund Payments are reasonable and proper. The Commission clearly has been concerned that the Infrastructure Agreement "includes unequal refunding structures, cost caps, priority services, and penalties that may not be in line with [the] Commission's standards."[22] In its July 16, 2010 Closing Brief, RUCO contended that "immediate recovery of 100% of [the] refunds paid to Pulte is not fair and reasonable."[23] In its July 16, 2010 Initial Post-Hearing Brief, after acknowledging "several parties" in this proceeding have noted the unfairness of the Disputed Refund Payments, Staff continued by suggesting that the Commission could recognize and respond to the facts which support such unfairness when deciding on the new rates.[24] In its Initial Post-Hearing Brief, Staff also specifically noted that the Commission left open scrutiny of the reasonableness of the balloon payment.[25] Accordingly, any portion of the Disputed Refund Payments that AAWC is unable to prove are reasonable and proper should be excluded from rate base and denied any related ratemaking recognition.

AAWC again claims that the doctrine of equitable estoppel prevents the Commission from adopting Anthem's proposed remedy of disallowing the Disputed Refund Payments.[26] But again, "where the public interest is involved neither estoppel nor laches can be permitted to override that interest."[27] Further, assuming, arguendo, that the estoppel doctrine applied in this instance, AAWC cannot claim it paid the Disputed Refund Payments in reasonable reliance on the

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[22] *Supra* n. 20. Additional evidence that the Disputed Refund Payments are not in line with the Commission's standards is set forth in Schedule JCM-1 footnote 4 of Staff's Report prepared in connection with AAWC's August 26, 2009 financing application. Staff notes that it "typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC, for private and investor owned utilities." AAWC's AIAC and CIAC funding ratio listed in the schedule shows that its ratio is considerably higher, nearly 40%. Staff Report, Docket No. E-01345A-06-0779.

[23] RUCO's Closing Brief at 37.

[24] Staff's Initial Post-Hearing Brief at 16.

[25] *Id.* at 15.

[26] Post-Hearing Brief of Arizona-American Water Company at 25 n. 123.

[27] *Supra* n. 19.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

Commission's words or actions.[28] First, Citizens' and AAWC's attempts to have the Infrastructure Agreement approved by the Commission indicate the existence of a belief that the Commission's approval was necessary.[29] AAWC knew that the Commission had never approved the Infrastructure Agreement.[30] AAWC also presumably knew that the Commission had expressed its concern that "unequal refunding structures, cost caps, priority services, and penalties that may not be in line with [the] Commission's standards" were set forth in the Infrastructure Agreement.[31] Further, AAWC knew that there was a possibility that the Commission would not allow ratemaking recognition of the Disputed Refund Payments.[32] Finally, AAWC knew that the Commission had left the status of the reasonableness of the Infrastructure Agreement refund provisions as an open question in AAWC's last rate case involving the Anthem districts.[33] And yet, despite this knowledge, AAWC elected to make the Disputed Refund Payments. These facts do not support the case of equitable estoppel that AAWC endeavors to suggest. On the contrary, it would be unfair and against public interest to require Anthem residents to shoulder the burden of AAWC's imprudent decision to enter into a questionable financing arrangement and to pay the Disputed Refund Payments particularly, where the Commission's previously expressed discomfort with the Infrastructure Agreement provided adequate advance notice to AAWC that the Disputed Refund Payments were vulnerable to the prospect of disallowance in AAWC's future rate cases.[34]

C. If the Commission Allows Ratemaking Recognition of All or a Significant Portion of the Disputed Refund Payments, Anthem Advocates a Phase In of the Rates in Order to Mitigate Rate Shock.

In the event that the Commission allows recognition of all or a significant portion of the Disputed Refund Payments, Anthem urges the Commission to adopt a phase-in plan in order to mitigate rate shock for customers in the Anthem Water District and the Anthem/Agua Fria Wastewater District. Two different phase-in plans have been presented to the Commission:

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[28] *See* the Post-Hearing Brief of Arizona-American Water Company at 25 n. 122 for the elements of equitable estoppel.
[29] Cross-Examination of Paul G. Townsley, Phase I Tr. at 377:5-9.
[30] *Id.* at 377:25-378:6
[31] *Supra* n. 20.
[32] The Fourth Amendment, which Mr. Townsley negotiated on behalf of AAWC, states: "The ACC's decision regarding rate treatment for any amounts refunded pursuant to the previous agreement or other amounts included in this Fourth Amendment shall not affect the terms in this Fourth Amendment." Cross-Examination of Paul G. Townsley, Phase I Tr. at 359:5-11, 360:1-14.
[33] Cross-Examination of Paul G. Townsley, Phase I Tr. at 353:9-17; Thomas H. Campbell, Phase I Tr. at 281:23-282:3, 285:20-286:7.
[34] For a history of the Commission's treatment of the Infrastructure Agreement see Anthem's Pre-hearing Memorandum on Disputed Refund Payment Issue.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

(i) Mr. Dan Neidlinger's ratable plant transfer plan, as articulated in Anthem's Initial Post-Hearing Brief[35] and (ii) RUCO's proposal "patterned on the standard ratemaking treatment for advances in aid of construction."[36] Anthem witness Mr. Neidlinger proposed removing the Anthem water and wastewater plant and related accumulated depreciation associated with the Disputed Refund Payments from plant in service for purposes of rate making in this proceeding. The net plant would be "parked" or deferred for purposes of this proceeding and transferred into plant in service ratably over the five-year period of 2009 through 2013. In its July 16, 2010 Closing Brief, RUCO proposed an alternative phase-in plan which would also allow AAWC to be made whole over a longer period of time.[37] RUCO's phase-in plan would mitigate, though in a more limited fashion than Mr. Neidlinger's ratable plant transfer plan, the rate shock that would otherwise result from the rates sought by AAWC in this case. Anthem prefers Mr. Neidlinger's plan which allows AAWC to recover the Disputed Refund Payments over a shorter period of time than the RUCO plan and is ultimately less expensive for ratepayers.

AAWC has not yet had the opportunity to respond to RUCO's phase-in proposal. However, it is conceivable that AAWC will pose objections to RUCO's phase-in plan similar to the objections that it has made to Mr. Neidlinger's ratable plant transfer plan. Therefore, for purposes of this Section II.C., Anthem's analysis and criticism of AAWC's response to Mr. Neidlinger's plan are equally applicable to such a critique of RUCO's phase-in plan. For instance, AAWC has argued that Mr. Neidlinger's phase-in plan requires a substantial write-off pursuant to financial accounting standards ASC 980-340 (formerly SFAS 92) pertaining to phase-in plans and ASC 980-360 (formerly SFAS 90) pertaining to plant disallowance.[38] Such an argument should be rejected by the Commission. SFAS 90 states that when it becomes probable that part of the cost of a recently completed plant will be disallowed for ratemaking purposes and a reasonable estimate of the amount of disallowance can be made, then that amount will be deducted

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[35] Anthem Community Council's Initial Post-Hearing Brief at 8-10.

[36] RUCO's July 16, 2010 Closing Brief at 42-43. A.A.C. R14-2-406(D) prescribes a ten percent/ten-year refund formula that is to be used as a guideline for the refund of advances in-aid-of construction. Any amount not recovered at the end of the ten-year period converts to CIAC. For a more complete discussion regarding the application of A.A.C. R14-2-406, see Anthem's April 16, 2010 Pre-hearing Memorandum on Disputed Refund Payment Issue.

[37] AAWC argues that Mr. Neidlinger's plan "would deny the Company a return on and of its investment" but both of the phase-in plans allow AAWC return of its investment. The issue is merely one of timing. *See* Post-Hearing Brief of Arizona-American Water Company at 19.

[38] *Id.* at 18.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

from the reported cost and recognized as a loss. Because under both Mr. Neidlinger's plan and the RUCO plan AAWC can eventually recover all the costs of the Anthem plant associated with the Disputed Refund Payments, it is not "probable that part of the cost" of the Anthem plant will be disallowed for ratemaking purposes. Thus, AAWC's asserted SFAS 90 concerns do not apply to either of the proposed phase-in plans.

AAWC claims that the implementation of Mr. Neidlinger's plan will result in "severe financial consequences" to AAWC due to AAWC's intimated election[39] to write-off the Disputed Refund Payments. While Anthem recognizes that AAWC does have financial challenges, Anthem suggests that AAWC's predictions of financial ruin resulting from the adoption of Mr. Neidlinger's plan are exaggerated and unsubstantiated. Generally, AAWC's testimony shows that its financial condition is improving. In 2009, AAWC recorded positive net income.[40] In each of its financing applications submitted to the Commission in 2009, AAWC indicated that it had sufficient revenue to cover its expected debt service payments.[41] Yet in his testimony before the Commission, Mr. Paul Townsley went so far as to state that if Mr. Neidlinger's ratable plant transfer plan is adopted, AAWC would be left in the position of trying "to find a bank or some other institution that would be willing to lend" AAWC "enough cash to continue to pay our utility bills."[42]

Anthem finds this statement to be extreme considering the reality that AAWC is wholly-owned by the largest investor-owned water and wastewater utility company in the United States, American Water Works Company, Inc. ("American Water"), as measured both by operating revenue and population served. In 2009, American Water reported revenues of $2.45 billion and net plant of $11.5 billion.[43] In comparison, AAWC's operations are of such slight significance to American Water's overall financial picture that AAWC's revenues amount to little more than a

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[39] Anthem stands by the arguments with respect to the application of ASC 980-340 (formerly SFAS 92) and ASC 980-360 (formerly SFAS 90) set forth in its Initial Post-Hearing Brief. Anthem agrees that, for AAWC's financial reporting purposes, AAWC and its outside auditors have the discretion to decide the ultimate accounting treatment of the Disputed Refund Payments under Mr. Neidlinger's ratable plant transfer plan. In that regard, in American Water Works Company, Inc. Form 10-K for the period ending December 31, 2008, Management's Discussion and Analysis of Financial Conditions and Results of Operations indicates that in connection with the preparation of American Water's consolidated financial statements as of December 31, 2006, American Water and its outside auditor identified six material weaknesses in American Water's internal control over financial reporting. As of December 31, 2008, American Water incurred $58.4 million to remediate the material weaknesses, and except for control deficiencies relating to the maintenance of contracts and agreements, all material weaknesses had been remediated.

[40] Cross-Examination of Paul G. Townsley, Phase I Tr. at 301:14-19.

[41] Financing Application Arizona-American Water Company, August 26, 2009, Docket No. WS-01303A-0407 at 4; Arizona-American Water Company, Financing Application, March 25, 2009, Docket No. WS-01303A-0152 at 3.

[42] Cross-Examination of Paul G. Townsley, Phase I Tr. at 375:24-376-6.

[43] Direct Examination of Michael L. Arndt, Phase II Tr. at 585:10-12.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
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footnote in American Water's annual reports.[44] Therefore, in order to gauge the veracity of AAWC's claims that the adoption of Mr. Neidlinger's ratable plant transfer plan would literally leave AAWC without enough money to keep its lights on, it is important to understand AAWC's relationship to American Water and to American Water's wholly-owned financing affiliate, American Water Capital Corp. ("American Capital").

AAWC has represented to the Commission that American Capital is the primary financing entity for all American Water's subsidiary utility companies.[45] As wholly-owned entities of American Water, 100% of the stock of both AAWC and American Capital is owned by American Water and neither AAWC nor American Capital issues stock to any other person or entity. All profit and loss resulting from the operations of both AAWC and American Capital ultimately flow to American Water, and if they are material amounts, those profits and losses appear on the consolidated financial statements of American Water. Outside investors review American Water's consolidated financial statements when deciding whether to buy or sell American Water's stock. Thus, even if AAWC did elect a write-off under Mr. Neidlinger's ratable plant transfer plan, it is unlikely that the event would be material enough to be included in American Water's consolidated financial statements.[46]

Mr. Townsley stated that the adoption of Mr. Neidlinger's ratable plant transfer plan would render AAWC unable to attract equity from American Water and would require AAWC to seek debt on a stand-alone basis, resulting in very expensive debt.[47] Again, American Capital's purpose is to finance or guaranty American Water's subsidies and thereby result in less expensive and less restrictive financings. It is unclear, then, why American Capital would suddenly refuse to finance or guaranty AAWC's debt since the impact of higher borrowing costs paid to a third-party lender and more restrictive debt covenants would negatively affect AAWC, American Capital and American Water. Further, it does not appear that American Water really intends to financially abandon AAWC. In the notes to AAWC's audited financial statements for the year ended

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[44] *See* Anthem Community Council's Initial Post-Hearing Brief at 2.
[45] Financing Application Arizona-American Water Company, August 26, 2009, Docket No. WS-01303A-0407 at 2.
[46] Direct Examination of Michael L. Arndt, Phase II Tr. at 587:4-9. Mr. Arndt testified that, for purposes of American Water's consolidated financial statements, any adjustment that the AAWC elected could be supported by a footnote explaining the Commission's adoption of the ratable plant transfer plan. Cross-Examination of Michael L. Arndt, Phase II Tr. at 598:5-18.
[47] Cross-Examination of Paul G. Townsley, Phase I Tr. at 375:24-376-6.

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December 31, 2008, the following note appears: "[American Water], through [American Capital], has committed to make additional financing available to the Company, as needed to pay its obligations as they come due."[48] Also, as recently as August 26, 2009, AAWC sought Commission approval for authorization to enter into a refinancing transaction with American Capital.[49] Finally, there is no evidence in the record supporting Mr. Townsley's assertion that AAWC's stand-alone debt would be expensive. On the contrary, on June 16, 2009, AAWC borrowed $2,300,000 on a stand-alone basis from the Water Infrastructure Authority of Arizona ("WIFA"), a state agency, pursuant to a program promulgated under the American Recovery and Reinvestment Act of 2009.[50] The terms of the loan from WIFA included a 6.0% per annum interest rate on approximately one-half of the principal amount of the loan and the forgiveness of the other one-half.[51] This can hardly be considered to be expensive debt. Thus, Mr. Townsley's predictions of financial ruin that would result from the adoption of Mr. Neidlinger's ratable plant transfer plan seem speculative at best. As a consequence, the Commission should not act or be deterred from acting based on mere speculation.[52]

AAWC states that Mr. Neidlinger's plan is unworkable because it does not identify particular assets that AAWC would assign to future use.[53] This argument is a pretense because it assumes that the Disputed Refund Payments are based upon a typical AIAC repayment structure where specific infrastructure is identified. However, in Anthem Data Request 1.2 and 1.3, Anthem asked AAWC to provide a schedule by plant account of the AIAC refunds to Pulte.[54] In response, the AAWC stated: "Refunds to Pulte are not associated with any specific plant accounts and, therefore, likewise not associated with any specific accumulated depreciations amounts. Rather, the Agreement between Del Webb and Citizens provided that a specific amount would be refunded

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[48] Arizona-American Water Company (a wholly-owned subsidiary of American Water Works Company, Inc.) Financial Statements as of and for the years ended December 31, 2008 and 2007 at 16.
[49] Financing Application Arizona-American Water Company, August 26, 2009, Docket No. WS-01303A-0407.
[50] Staff Report, Docket No. WS-01303A-0407 at 2.
[51] *Id.*
[52] In *Re New Jersey-American Water Company, Inc.*, the New Jersey Board of Public Utilities declined to adopt a phase-in plan where American Water's subsidiary demonstrated that the impact of the phase-in was likely to result in a downgrade of the company's bond rating and a corresponding increase in the cost of debt by approximately 40 basis points and where the average monthly bill impact of the phase-in plan on ratepayers was less than $3.50 per month. 1996 WL 210865 (N.J.B.P.U 1996). Exh. A-47 at 4-5, 9. However, in the instant proceedings, AAWC cannot point to a similar tangible impact since its debt is not rated investment grade.
[53] Post-Hearing Brief of Arizona-American Water Company at 19.
[54] Exh. Anthem-11.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

based on the number of EDU's (equivalent dwelling units) that were customers at the end of any one year."[55] Accordingly, each EDU is a composite dollar amount representing the total amount of water utility plant (meters, services, transmission, storage, pumping, etc.) needed to serve one residential customer. Under this refunding mechanism, there is no need to identify specific plant accounts.

A phase-in plan is appropriate considering the controversy surrounding the Disputed Refund Payments, the need to mitigate rate shock for Anthem residents, and the fact that AAWC benefited from the interest-free use of plant financed with AIAC for many years.[56] In that regard, Anthem witness Michael L. Arndt testified that it would be appropriate, in terms of matching principles, for the Commission not to allow a return on deferrals since AAWC did not pay interest on the Disputed Refund Payments.[57] The court in *Cogent Public Service Inc. v. Arizona Corporation Commission* recognized that "the antithesis of a just and reasonable rate is one that would permit a utility's stockholders to recover a return on money which they, in fact, never invested."[58] In light of the foregoing, a phase-in plan is a meaningful approach to "balance the equities."[59]

D. Only 16.5% of the Northwest Treatment Plant Cost Should Be Allocated to the Anthem/Agua Fria Wastewater District for Stand-Alone Ratemaking Purchases.[60]

In its July 16, 2010 Initial Post-Hearing Brief and in order to support its argument for a 28% allocation of the Northwest Wastewater Treatment Plant to the Anthem/Agua Fria Wastewater District, Staff revised its mathematical computations from those discussed during the evidentiary hearing. The analysis is not compelling. Staff's customer growth projections continue to be inaccurate and unrealistic in light of the current sluggish real estate market that will likely experience a sustained delay in recovery.

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55 *Id.*
56 Direct Examination of Michael L. Arndt, Phase II Tr. 591:11-20.
57 *Id.*
58 142 Ariz. 52, 57, 688 P.2d 698, 703 (App. 1984) (denying the inclusion of CIAC in rate base and citing *State ex. Rel. Valley Sewage Co. v. Public Service Commission*, 515 S.W.2d 845, 851 (Mo. App. 1974).
59 Staff's Initial Post-Hearing Brief at 16.
60 The discussion in this Section II.D. assumes the continued mini-consolidation of the Anthem/Agua Fria Wastewater District for ratemaking purposes. In that regard, Anthem wastewater customers receive no wastewater treatment services from the Northwest Treatment Plant and thus the Northwest Plant is not used and useful as to the Anthem wastewater customers. "There is no line that connects the [Northwest Treatment] Plant and the Anthem community." Cross-Examination of Linda Gutowski, Phase I Tr. at 616:1-6.

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4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

At the hearing, Staff's 28% allocation percentage was based on an annual customer growth rate for Corte Bella of 704 customers for the five (5) year period beginning in 2009 and reaching 6,336 Corte Bella customers by 2013.[61] Staff relied upon this 704 customer annual growth rate projection despite the fact that Corte Bella lost 59 customers in 2008 and added only 98 customers in 2009. To achieve Staff's customer count of 6,336[62] customers at the end of 2013, Corte Bella would have to grow at the rate of 855 customers per year for years 2010 through 2013. This is a wholly unrealistic expectation.

In its July 16, 2010 Initial Post-Hearing Brief, Staff revised its growth rate for Corte Belle downward to 554 customers per year in recognition of the fact, as noted by Anthem witness Mr. Neidlinger, that there were 602 customers in the Corte Bella service area in January of 2005. However, Staff has not correspondingly reduced its proposed allocation percentage consistent with this revision which, as shown on Schedule 1 prepared by Mr. Neidlinger and attached hereto, would lower the allocation of the Northwest Treatment Plant to the Anthem/Agua Fria Wastewater District to 24.5% using Staff's original methodology. Ultimately, however, Staff's revised allocation is still in error.

The Commission has historically relied upon the principle of known and measurable changes when deciding important ratemaking issues, rather than rely on forecasted changes or projections. Using the principle of known and measurable changes, Schedule 1 demonstrates that the resulting allocation of the Northwest Treatment Plant to the Anthem/Agua Fria Wastewater District should be on the order of 14.0%-14.5% or approximately 1/2 of the 28% recommended by Staff. The 16.5% allocation recommended by Anthem is based upon the more reasonable growth rate of 111 customers per year in Corte Bella, shown on Schedule 1. Mr. Neidlinger's projection appropriately accounts for recent and continuing reductions in customer growth rates due to the foreseeable sustained flat housing market and should be adopted by the Commission in this case.

AAWC inexplicably supports Staff's 28% allocation factor in this case even though it does not dispute Mr. Neidlinger's customer growth numbers.[63] AAWC argues that extensive back and

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[61] Cross-Examination of Dorothy M. Hains, Phase I Tr. at 799:23-24.
[62] 6,336 customers is used as the foundation for the 28% allocation calculation.
[63] Direct Examination of Thomas M. Broderick, Phase I Tr. at 146:25-147:2.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

forth modification of the allocation percentage based upon real estate cycles is not good public policy.[64] In this instance, accurate growth data was not previously available with respect to the Corte Bella area but now is.[65] Good public policy requires the Commission to correctly assign cost responsibility for all ratemaking components, especially those that have a significant impact on ratepayers like the allocation of the Northwest Treatment Plant. Therefore, the Commission's should allocate 16.5% of the Northwest Wastewater Treatment Plant to the Anthem/Agua Fria Wastewater District.

E. A Rate of Return of 6.37% Is Fair and Reasonable.

In its Initial Post-Hearing Brief, Anthem supported a not to exceed rate of return ("ROR") of 6.77% which is the ROR advanced by RUCO during the evidentiary hearing. While RUCO continues to support its proposed ROR of 6.77% in its July 16, 2010 Closing Brief, it also demonstrates that an even lower rate of return can be supported by current economic indicators reflecting American Water's financial strength.[66] RUCO's revised computations suggest that a 6.37% ROR, based on American Capital's lower cost of short-term debt as reported in American Water's most recent 10-K filing with the SEC, is reasonable and appropriate. Further, investment expert Steven Puhr's written public comment demonstrates that a 5.23% ROR is also reasonable and appropriate factoring in the same lower commercial paper cost and making additional adjustments to select a more comparable, and therefore more appropriate, data set.[67] For the reasons articulated by RUCO and Mr. Puhr, Anthem rejects Staff's and the Company's proposed ROR of 7.20% as being unreasonable and supports a ROR of 6.37%.

Anthem further suggests that the establishment of the ROR is yet another area where the Company's argument requires scrutiny. While theoretical battles regarding return on equity are commonplace in rate cases, the reality in this instance is that American Water is the sole shareholder of AAWC and AAWC's stock is not publicly sold. Accordingly, any claim by AAWC that a higher return on equity and, correspondingly, a higher ROR is needed in order to attract

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64 Post-Hearing Brief of Arizona-American Water Company at 15-16.
65 Cross-Examination of Dorothy M. Hains, Phase I Tr. at 790:14-19.
66 *See* RUCO's Closing Brief at 44-53. In a Staff Report, dated February 22, 2010, AAWC acknowledged that interest rates are currently at historic lows. Docket No. WS-01303A-09-0407 at 2.
67 Opinion and supporting materials filed by Stephen P. Puhr as public comment with the Commission's Docket Control on April 28, 2010 in this proceeding.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
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SCOTTSDALE, ARIZONA 85251-3693

independent equity capital does not account for real-world phenomena in this instance and is somewhat academic in light of American Water's pledge to continue to provide AAWC with needed capital through AWCC.[68]

F. Anthem Supports the Company-Wide Rate Consolidation of All Water Districts and All Wastewater Districts within the State of Arizona by Means of AAWC's Preferred Consolidation Scenario One.

1. Company-wide consolidation benefits all AAWC customers over time.

Anthem urges the Commission to consolidate all AAWC's water and wastewater districts in the State of Arizona through a five-step implementation plan as set forth in AAWC's Preferred Consolidation Scenario One. As further explained in Anthem's Initial Post-Hearing Brief, rate consolidation is a long-term solution that, over the long haul, benefits all customers. Although AAWC's July 16, 2010 Initial Post-Hearing Brief does not forcefully advocate company-wide consolidation, the reality is that Mr. Townsley, AAWC's chief executive, strongly supported consolidation both in his official and personal capacity when he testified in this proceeding.[69] Among other noteworthy benefits are increased administrative efficiency and improvements to AAWC's ability to make needed capital improvements while mitigating rate shock. Mr. Townsley commented that the benefits of consolidation are particularly true for older and smaller districts that may experience disproportionately higher rates without consolidation. In fact, Mr. Townsley testified that customers residing in Sun City, despite their current opposition to consolidation, are likely to be the greatest beneficiaries of consolidation due to Sun City's aging infrastructure.[70] Mr. Townsley also recognized that consolidation removes barriers to AAWC's ability to assist troubled utilities. In that regard, in Decision No. 63584 approving the transfer of Citizens' water and wastewater utility assets to AAWC, the Commission stated that AAWC was expected to seriously consider acquiring the small water and wastewater utilities in the State in need of technical and financial assistance. Consolidation then, would further the Commission's agenda.[71]

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68 *Supra* n. 48.
69 Direct Examination of Paul G. Townsley, Phase II Tr. at 347:8-352:5.
70 *Id.* at 355:9-357:4.
71 Docket Nos. W-01032a-00-0192 *et al.* at 13.

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4250 NORTH DRINKWATER BOULEVARD
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2. The Commission should reject RUCO's legal arguments opposing consolidation.

RUCO strongly opposed company-wide consolidation during the hearing and in its July 16, 2010 Closing Brief. Among its arguments against company-wide rate consolidation, RUCO asserts that rate consolidation would be illegal in this case and that consolidation is against the public interest.[72] The Commission should reject RUCO's legal arguments and conclusions for the reasons set forth below. In support of RUCO's proposition that company-wide rate consolidation is illegal, RUCO asserts the following:

> To consolidate rates using two different test years, different cost of equity, different WACCs and different cost of debt conflicts with the constitutional requirement to set rates based on the fair value of the utility's property – not the average of different fair value findings. For to do so, renders the fair value determination in both cases meaningless.[73]

However, at the same time, RUCO acknowledges that "[t]he situation here poses a factual situation of first impression."[74] RUCO's perception of the "situation" currently before the Commission with respect to the subject of company-wide rate consolidation, and RUCO's resulting conclusion as to the illegality are each misplaced.

More specifically, as the Arizona Supreme Court observed in U.S. West Communications, Inc. v. Arizona Corporation Commission:[75]

> . . . while the constitution clearly requires the Arizona Corporation Commission to perform a fair value determination, only our jurisprudence dictates that this finding be plugged into a rigid formula as part of the rate-setting process. Neither section 3 nor section 14 of the constitution requires the corporation commission to use fair value as the *exclusive* "rate basis."(emphasis in original)[76]
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> * * *
>
> The fair value of a public service corporation's Arizona property may be important in determining and avoiding the harsh extremes of the rate spectrum . . . The Commission has broad discretion, however, to determine the weight to be given this factor in any particular case.[77]

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[72] RUCO's Closing Brief at 54, 58.
[73] *Id.* at 55.
[74] *Id.*
[75] 201 Ariz. 242, 34 P.3d 351 (2001).
[76] *Id.* at 245-46, 34 P.3d at 354-55.
[77] *Id.* at 246, 34 P.3d at 355.

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4250 NORTH DRINKWATER BOULEVARD
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Against this background, Anthem submits that the Commission has the authority and the discretion to consider the different test years, costs of equity and costs of debt to which RUCO refers, with the objective of determining whether the rates and charges which would occur under a given company-wide rate consolidation proposal would result in "just and reasonable rates and charges" for AAWC and its water and wastewater customers. It is the justness and reasonableness of those rates and charges which is the ultimate constitutional ratemaking criterion; and, in determining the same, the Commission may consider all the various arguments for and against company-wide consolidation, provided it also determines and considers the fair value of AAWC's water and wastewater districts. In that regard, Anthem is not proposing and the Commission is not required to "average" those various fair value determinations, which RUCO's line of argument appears to assume as an analytical predicate.

Anthem further believes that the latitude to be accorded to the Commission's exercise of such discretion also includes flexibility as to the timing between when various fair value determinations are made, as long as the time period separating such determinations is reasonable. In this instance, Anthem believes that the passage of time between the fair value determinations made in Docket Nos. W-01303A-08-0227 and SW-01303A-08-0227 and the time when such determinations will be made in this proceeding is not such as to make unreasonable the Commission's consideration of all such fair value determinations in connection with a decision on the appropriateness of company-wide rate consolidation for AAWC and its ratepayers. Accordingly, Anthem suggests that RUCO's arguments as to the illegality of such a course of action be rejected.

In addition, RUCO briefly asserts that AAWC has failed to comply with A.A.C. R14-2-103(A)(3)(p) because AAWC has not selected a single test year.[78] This argument is also misplaced because it is the Commission that initiated the use of two separate test years in conjunction with its consideration of the concept of company-wide consolidation of rates for AAWC and because the Commission has the authority and discretion to waive compliance with its

[78] RUCO's Closing Brief at 57.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

rules and regulations when it determines such waiver would be in the public interest. RUCO also argues that allowing "a utility to set rates using two test years will result in much mischief in the future" thereby giving rise to the type of concern raised in *Scates v. ACC.*[79] Again, RUCO's perception and argument is misplaced because it is entirely within the control of the Commission as to when two different test years may be used in a ratemaking proceeding and for what purpose. That is not a determination which is within the discretion of a given public service corporation. The occurrence of such "mischief" as RUCO apprehends could occur only with the knowing consent of the Commission. In summary, for the various reasons discussed above, RUCO's arguments as to the illegality of company-wide rate consolidation in this proceeding should be rejected.

3. The Commission should also reject RUCO's public policy arguments opposing consolidation.

RUCO also argues that company-wide consolidation is against the public interest, in part, because it violates the revenue neutrality requirement set forth in Decision No. 71410.[80] RUCO reads Decision No. 71410 to require the referenced revenue neutrality set forth in Decision No. 71410 to apply to each of AAWC's water districts.[81] RUCO's interpretation cannot be reconciled with the Commission's desire to explore consolidation. Nor does the language of Decision No. 71410, which refers to "all" of AAWC's water and wastewater districts, require RUCO's narrow construction.[82] Moreover, as noted by RUCO, it is mathematically impossible to create a consolidated rate design whereby each water and wastewater district retains its individual revenue requirement, which the Commission presumably knew at the time it issued Decision No. 71410.[83] It obviously was not the Commission's intention for its wording in Decision No. 71410 to frustrate the intent of the order. Therefore, RUCO's interpretation is flawed.

Finally, with respect to RUCO's additional public policy arguments in opposition to consolidation, in the interest of brevity, Anthem incorporates herein by reference Anthem's

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[79] 118 Ariz. 531, 578 P.2d 612 (App. 1978); *see* RUCO's Closing Brief at 57.
[80] Docket Nos. W-01303A-08-0227 and SW-01303A-08-0227.
[81] *See* RUCO's Closing Brief at 58.
[82] Cross-Examination of Linda Gutowski, Phase II Tr. 1533:25-1534:1.
[83] Rate Consolidation Direct Testimony of Jodi A. Jerich, Exh. R-21 at 12.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

discussion of the numerous public policy considerations favoring consolidation set forth in its July 16, 2010 Initial Post-Hearing Brief and in Section II.F.1. hereof.

G. Alternatively, Anthem Supports the Stand-Alone Rate Design for Anthem Proposed by AAWC, as Modified to Deconsolidate the Anthem/Agua Fria Wastewater District.

1. AAWC's proposed stand-alone rate design for Anthem is acceptable; Staff's proposed stand-alone rate design for Anthem is unacceptable.

In the event that the Commission does not adopt company-wide consolidated rates in this proceeding, the current fixed/commodity rate structure of the Anthem Water District and the Anthem/Agua Fria Wastewater District should be retained and any rate increases applied on an across-the-board basis. AAWC's proposals maintain the current tier levels for all meter sizes and increase all customers' bills by the same percentage rather than shifting, without cost of service support, revenue responsibility from the residential to the commercial classes of customers.

Because Staff's proposed changes to water and wastewater rate designs are without adequate foundation or support and would adversely affect Anthem customers, the Commission should reject Staff's proposed stand-alone rate design for Anthem. AAWC, RUCO and Anthem's water rate design proposals are markedly different than those proposed by Staff. The only commonality between each of the proposals is the number of tiers in the rate design for residential and commercial customers.[84] Staff's tier break points differ significantly from those proposed by AAWC and yield a far different result. As discussed in Anthem's July 16, 2010 Initial Post-Hearing Brief, Staff's lowering in the tier break points for commercial customers coupled with greater-than-average increases in the second tier rate could increase some commercial customers' bills by as much as 250%.

[84] Staff's Initial Post-Hearing Brief at 17.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

2. If the Commission does not adopt company-wide consolidation, then there is no substantial basis to continue the consolidation of the Anthem/Agua Fria Wastewater District.

Absent a decision by the Commission to consolidate all AAWC's water and wastewater districts in the State of Arizona, there is no substantial reason for the continued consolidation of these two geographically remote wastewater districts for ratemaking purposes.[85] For the reasons set forth in Anthem's July 16, 2010 Initial Post-Hearing Brief, the deconsolidation of the Anthem/Agua Fria Wastewater District for cost allocation and rate design purposes should be implemented as part of any final Commission decision in this proceeding. In the event the Commission concludes that the record in this proceeding does not contain sufficient data to generate stand-alone rate designs for the resulting Anthem Wastewater District and Agua Fria Wastewater District at this time, then Anthem requests that the Commission (i) order a rate design for the Anthem/Agua Fria Wastewater District as a consolidated district on an interim basis and (ii) order the docket in this proceeding to remain open for the limited purpose of designing and implementing stand-alone revenue requirements and rate designs for the Anthem Wastewater District and Agua Fria Wastewater District, respectively, as soon as practicable, and in any event, well in advance of AAWC's next rate case.

III. CONCLUSION

For the reasons discussed above and based upon the record in the instant proceeding, Anthem requests the Commission enter an Opinion and Order to provide for the following:

(i) the permanent exclusion from AAWC's rate base and denial of any related ratemaking recognition of the Disputed Pulte Refund payments or, in the event that the Commission determines to allow the recognition of the Disputed Pulte Refund payments; then

(ii) the permanent exclusion from AAWC's rate base and denial of any related ratemaking recognition of any portion of the Disputed Pulte Refund payments that have not been shown by AAWC to be reasonable and proper and, if the Commission determines to allow ratemaking recognition of a significant portion of the Disputed Refund Payments; then

(iii) the implementation of a phase in of the rates in order to mitigate rate shock on Anthem water and wastewater ratepayers; and

[85] AAWC originally proposed deconsolidation of the Anthem/Agua Fria Wastewater District in Docket Nos. W-01303A-08-0227 and SW-01303A-08-0227.

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

(iv) a reduction in the portion of the Northwest Treatment Plant cost to be allocated to the Anthem/Agua Fria Wastewater District for stand-alone ratemaking purposes to 16.5%; and

(v) the establishment of the revenue requirement for AAWC based on a rate of return of 6.37%; and

(vi) the company-wide consolidation of all AAWC's water and wastewater districts within the State of Arizona using AAWC's Scenario One; or

(vii) the deconsolidation of the Anthem/Agua Fria Wastewater District and the establishment of stand-alone rates for each if company-wide consolidation is not approved.

DATED this 6th day of August, 2010.

Respectfully submitted,

Judith M. Dworkin
Roxann S. Gallagher
Sacks Tierney P.A.
4250 N. Drinkwater Blvd., 4th Floor
Scottsdale, Arizona 85251-3693

and

Lawrence V. Robertson, Jr.
P.O. Box 1448
Tubac, Arizona 85646-1448

By: _____
Judith M. Dworkin
Attorneys for Anthem Community Council

ORIGINAL AND THIRTEEN (13) COPIES
of the foregoing filed
this 6th day of August, 2010 to:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

COPY of the foregoing mailed or e-mailed this 6th day of August, 2010, to:

Teena Wolfe, Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Thomas H. Campbell
TCampbell@LRLaw.com
Michael T. Hallam
MHallam@LRLaw.com
Lewis and Roca, LLP
40 N. Central Avenue
Phoenix, AZ 85004-4429

Daniel Pozefsky
DPozefsky@azruco.gov
RUCO
1110 W. Washington St., Suite 220
Phoenix, AZ 85007

Janice M. Alward, Chief Counsel
JAlward@azcc.gov
Legal Division
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007-2927

Steve Olea, Director
SOlea@azcc.gov
Utilities Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Lyn Farmer
Lfarmer@azcc.gov
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Robert J. Metli
rmetli@swlaw.com
Jeffrey W. Crockett
jcrockett@swlaw.com
Snell & Wilmer LLP
400 E Van Buren
Phoenix, AZ 85004-2202
Attorneys for the Resorts

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

Michael Patten
mpatten@rdp-law.com
Roshka DeWulf & Patten PLC
400 E Van Buren Suite 800
Phoenix, AZ 85004-2262

Greg Patterson
gpatterson3@cox.net
916 W. Adams, Suite 3
Phoenix, AZ 85007
Attorneys for WUAA

W.R. Hansen
jpbillscwaz@aol.com
12302 W. Swallow Drive
Sun City West, AZ 85024

Bradley J. Herrema, Esq.
BHerrema@bhfs.com
Brownstein Hyatt Farber Schreck, LLP
21 E. Carrillo Street
Santa Barbara, CA 93101
Attorneys for Anthem Golf and Country Club

Norman D. James, Esq.
njames@fclaw.com
Fennemore Craig
3003 N. Central Avenue, Suite 2600
Phoenix, AZ 85012
Attorneys for DMB White Tank, LLC

Marshall Magruder, Esq.
mmagruder@earthlink.net
P.O. Box 1267
Tubac, AZ 85646-1267

Andrew M. Miller, Esq.
amiller@paradisevalleyaz.gov
Town Attorney
6401 E. Lincoln Drive
Paradise Valley, AZ 85253
Attorneys for Town of Paradise Valley

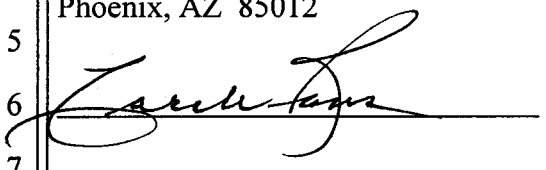
Joan S. Burke, Esq.
joan@jsburkelaw.com
Law Office of Joan S. Burke
1650 N. First Avenue
Phoenix, AZ 85003
Attorneys for Mashie, LLC, dba Corte Bella Golf Club

Larry D. Woods
15141 W. Horseman Lane
Sun City West, AZ 85375

SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

Philip Cook
10122 W. Signal Butte Circle
Sun City, AZ 85373

Dan Neidlinger
Neidlinger & Associates, Ltd.
3020 N. 17th Drive
Phoenix, AZ 85012



SACKS TIERNEY P.A., ATTORNEYS
4250 NORTH DRINKWATER BOULEVARD
FOURTH FLOOR
SCOTTSDALE, ARIZONA 85251-3693

Anthem Reply Brief
Schedule 1

ARIZONA-AMERICAN WATER COMPANY
ACC DOCKET NOS. W-01303A-09-0343 & SW-01303A-09-0343
ANTHEM WATER & WASTEWATER DISTRICTS

NORTHWEST WW PLANT ALLOCATION
Comparison of Allocation Factors Under Alternative Approaches

DESCRIPTION	TOTAL	NEAF OR CORTE BELLA	SUN CITY WEST
ALLOCATIONS BASED ON KNOW & MEASURABLE CHANGES			
Customers at 12-31-2008	17,784	2,816	14,968
Customers at 12-31-2009	17,876	2,914	14,962
Calculated Maximum Flows - 2008 (1)	3,346,944	473,088	2,873,856
Calculated Maximum Flows - 2009 (1)	3,362,256	489,552	2,872,704
Allocation Percentages - 2008	100.00%	14.13%	85.87%
Allocation Percentages - 2009	100.00%	14.56%	85.44%
ALLOCATIONS BASED ON STAFF FILING AND CORRECTED STAFF PROJECTIONS			
Staff - As Filed: (2)			
Annual Customer Growth	718	704	14
Customers at 12-31-13	21,374	6,336	15,038
Calculated Maximum Flows (1)	3,951,744	1,064,448	2,887,296
Allocation Percentages	100.00%	26.94%	73.06%
Staff - Per Opening Brief: (3)			
Annual Customer Growth	568	554	14
Customers at 12-31-13	20,624	5,586	15,038
Calculated Maximum Flows (1)	3,825,744	938,448	2,887,296
Allocation Percentages	100.00%	24.53%	75.47%
ALLOCATIONS BASED ON SURREBUTTAL TESTIMONY OF DAN L. NEIDLINGER (4)			
Annual Customer Growth	111	111	0
Customers at 12-31-13	18,320	3,358	14,962
Calculated Maximum Flows (1)	3,436,848	564,144	2,872,704
Allocation Percentages	100.00%	16.41%	83.59%

NOTES:
(1) Based on Staff Estimates of Maximum Daily Flows/Customer of 168 Gallons for Corte Bella and 192 Gallons for Sun City West
(2) Per Schedule DMH-1, Appended to Staff Response to Anthem Data Request 1.1
(3) Staff Opening Brief, Page 9, Line 12
(4) Surrebuttal Testimony of Dan L. Neidlinger, Exhibits DLN-1 and DLN-2